

Effective Programs & Strategies In Combating Procurement Fraud

September 9-11, 2008

Richmond, Virginia

TRAINING HYPOTHETICALS FOR DISCUSSION GROUPS

I. SAFETY BOLTS CASE

On March 17, 2007, Agent Tracy's supervisor hands her the following letter, and asks her to look into it.

To Whom It May Concern At The FBI:

I have been a quality control inspector at Safety Bolts for 10 years, and I have always been very proud of working for Safety Bolts. However, I can no longer say that. I used to think Safety Bolts as an ethical company, but that isn't true anymore. Things have changed since we got a new President, Marla Wolf, five years ago. Over the last few years, my boss, Roger Lambe, has told me not to bother doing some of the tests on the bolts and has directed me to falsify test results because it takes too long. Lambe is falsely signing the certificates that we give to the government to prove we did the tests. Some of my friends in manufacturing have told me that we're buying some cheaper materials than we used to. I'm worried sick about this because we have a lot of contracts with the government and these bolts are going on our fighter planes. I have complained to Lambe about this, but to no avail. He says that's just the way management wants things done now, and that I can just "put up or shut up." I'd like to someone at the FBI about this and I'm willing to cooperate any way I can. Please call me at home, not at work.

A Very Concerned Citizen,
Paul Bitter

cc. Safety Bolts Board of Directors, The Wall Street Journal, The United States Senate

Agent Tracy's brother flies F-16s for the Air Force, and the letter shakes her up. After some discussion with her supervisor, she contacts AUSA Mike Tiger to see what can be done. They both

agree that they should initiate an investigation.

1. Based on the factual information provided in the letter, can you identify the possible crimes that may have been committed? What is the potential harm to the government and/or the public that is raised by the allegations in this letter?
2. Who are the potential defendants?
3. How would you structure this investigation? What investigative resources would you need?
4. Should you notify the Air Force or other government or commercial contractors about possible defective bolts at this point in the investigation? Do you need to arrange to have them trace and hold the allegedly defective items?
5. Can you meet with Bitter without his lawyer present, if he has one? What if anything do you tell him about his status? What do you do if he says he doesn't want to talk to you without immunity?
6. What do you want to know from Bitter? How can he be of use to you in your investigation? What undercover opportunities would you consider? e.g., can Bitter call or meet with Wolfe? Lambe?
7. During the interview of Bitter he describes his familiarity with the fraudulent activity and offers to photocopy examples of some of the fraudulent documents and false testing reports. What guidance should you give Bitter? Do you take Bitter up on his offer to obtain documents at Safety Bolts, including materials from Lambe's desk and other information located in Lambe's office.
8. What are the advantages or disadvantages of trying to interview Safety Bolts employees before trying to obtain documents from the company?
9. What documents do you want from the company? Aside from testing and certification records, what else do you want to get? How will you obtain documents from Safety Bolts?
10. Are there search warrants that can be executed? What are the advantages/disadvantages in using a search warrant over an IG subpoena or grand jury subpoena?
11. Should you phone up the company's General Counsel? Should you tell them what you're looking at and ask for the company's

cooperation? What other issues should you discuss? e.g., preservation of documents; order in which you want documents produced to you; having company make employees available to you.

12. What are the implications of having a government agency involved? Should you attempt to interview the PCO, ACO and government users who purchased the bolts and suppliers/vendors who sold the inferior, non-conforming materials to the company? Are you interested in getting evidence of product failures or any complaints that the bolts were not meeting applicable specifications?

13. What if you learn that the Air Force did some testing of the bolts upon learning of your investigation and found that all the ones they tested were fine? Does this information have any impact on your criminal case? On your civil case?

Cooperation by the Company

Michael Craft, a well-known defense attorney and former United States Attorney, contacts AUSA Tiger and tells him that he has been retained by Safety Bolts. Craft says he has just finished conducting an internal investigation for Safety Bolts and that he "can explain everything." He meets with and Agent Tracy the next and tells him that he has concluded that the Safety Bolts senior management knew nothing of the false testing. Indeed, he says, "This was all the work of a rogue employee, Paul Bitter." Craft has interviewed Marla Wolfe, Roger Lambe and Sam Nerd, who is Lambe's supervisor and reports directly to Wolfe, and insists that they knew nothing about the false testing and records. Craft says that Bitter took it upon himself to falsify testing records and that Lambe had no idea that the tests had not been done when he signed all of Safety Bolts' certifications to the government, certifying that the company had tested the bolts and complied with government specifications. In conclusion, Craft tells Tiger and Agent Tracy that Safety Bolts should not be held criminally responsible for Bitter's action, and promises to give the government the evidence it needs to bring criminal charges against Bitter.

1. How do these facts alter your investigative strategy?
2. What corroborating evidence would you want Craft to provide to substantiate its findings and allegations against Bitter?
3. Should you ask for a copy of the report that Craft wrote summarizing the results of the internal investigation? What is the company's interest in giving it to you? Can you get copies

of any notes he took of his interviews with company employees?

4. What do you do/say to Craft if he tells you that he can't give you the report because all of his work is protected by the attorney client and work product privileges? Can you ask him to waive the privileges so that you can gain access to the information? What is the significance of the McNulty Memo? How can you use the McNulty Memo to get the information you want?

5. What is your position with respect to Safety Bolts paying (advancing/indemnifying) for counsel for current and former employees who are alleged to have engaged in wrongdoing?

II. ACME CONSTRUCTION COMPANY CASE

Jane is the GSA official in charge of procurement of construction services for all federal buildings in Texas. John runs Acme Construction Company, which specializes in small scale office renovations. Acme operates throughout the South and is respected for the quality of its work and known for its low prices. Several years ago when Jane was promoted to her current position, John remembered that they had gone to college together. John invited Jane to dinner at Houston's most luxurious restaurant to celebrate Jane's new job. At dinner, John asked Jane whether she could help Acme do more business renovating federal office buildings. Jane said she would see what she could do.

Over a five-year period, John made it a point to treat Jane to a nice dinner about once a month. Usually both Jane and John also brought their spouses. John also remembered Jane's birthday each year - usually with a \$200 Nordstrom gift certificate. On about 10 occasions during the same time period, John's company submitted bids to renovate Texas federal buildings. On each of these occasions, John called Jane and told her he hoped that Acme would get the contract. Jane was the deciding official on these contracts. Acme was awarded 8 of the 10 contracts it bid on - - it was the low bidder on 4 of those contracts. The contracts awarded to Acme totalled \$750,000 and Acme made \$500,000 in profits from these. After the largest of the contracts was awarded - - for \$300,000 - - John surprised Jane by telling her he had arranged a three day all expense paid golf trip for the two couples to Pebble Beach. Half of the contract awards took place more than five years ago.

On two occasions, John also asked Jane to recommend Acme to other prospective clients. Jane called her GSA counterpart in

Alabama and a friend of hers who is a City of Houston procurement official, and sang the company's praises. Acme then bid on, but did not win business in Alabama - it did get a \$1 million sole source contract from Houston.

The Administrator of GSA is active in the Republican National Committee, and Jane has made a point of telling him that John is her friend and a big Republican contributor.

1. Based on the factual information provided, can you identify the possible crimes that may have been committed?
2. How would you structure this investigation?

III. BigTime Company

Dudley Do-Right, a former manager for BigTime Construction Company, which is the prime contractor on a major federally funded subway construction project, tells your agent that BigTime is using Grey Eagle Construction Company as a nominal DBE (disadvantaged business enterprise) to carry out certain aspects of BigTime's \$21.2 million general contract to satisfy the federally mandated DBE requirements (and get DBE program credit. Do-Right says that Grey Eagle is simply a "front company" and is performing no "commercially useful function" on the contract. According to Do-Right, based on a secret side agreement between Big-Time's president and Grey Eagle's president, Gaylord Construction Company has been providing and supervising the laborers who are installing the cable in the subway tunnels. He insists that documents will show that the work was performed, managed and supervised by Gaylord's employees and, thus, that BigTime was improperly receiving DBE credit. And, he provides the agent with a copy of a "Certified Payroll Statement," signed by Grey Eagle's President, which falsely represents that the employees listed on Grey Eagle's certified payroll were paid and supervised by Grey Eagle.

Do-Right also revealed that BigTime has been seeking improper change orders and approvals from MTA officials to obtain approval for additional payments during the project. Do-Right states that BigTime has been making illegal cash payments, on a monthly basis, to Mr. A and Mr. B.

1. What possible offenses have been committed?
2. What investigative strategy would you follow? What resources would you need?

IV. Food for Thought

PHASE 1

A very experienced relator's counsel brings to the United States Attorney's office her client, who she identifies as a former business partner of a company that currently has the exclusive contract to supply food and other supplies to the US troops stationed in Guatemala. By way of background, shortly after withdrawing all US troops from Iraq, the United States together with the UK sent 900,000 Marines to Antigua, Guatemala, and the surrounding area based on intelligence that the area has turned into a haven for terrorists. Now the government has to feed the troops based there.

The potential relator's counsel offers to show you documents and provide tapes of business meetings that will show the fraudulent scheme devised by the contractor, a recently formed joint venture between an Arkansas company and a group of businessmen from Honduras. The contractor is named the Publico Comedero, Inc (PCI) and has its headquarters in Guatemala city with offices in Arkansas and Belize. In total, PCI has 120 employees including a president named Tony Fizz, a retired Army colonel. The documents and the testimony of the relator/former business partner of PCI will show, according to the potential relator's counsel, that even before submitting the bid for the contract to feed the troops in January 2006, the executives, including a founder/Board member and recently retired Army Commanding General, met and devised several schemes to overcharge the contracting agencies, the US Army Material Command and the Defense Logistics Agency.

Relator's counsel says she is holding off filing until she can discuss the case because her client has two former associates still working for PCI who can help in the investigation; and because "technically speaking" her client has criminal exposure because he participated in the early stages of the scheme, he had a falling out with the contractor over his share of the profits. She claims her client is an expert in prime vendor procurement and early-on objected to some of PCI's business practices.

The Army Materiel Command contract was awarded after a competition to PCI in 2006 before anyone knew there would be such a large need for this type of support in Guatemala. The Army is paying PCI over \$300 million a month on the contract which delegates to PCI all the duties associated with purchasing the food items and arranging for their delivery to government warehouses in Guatemala City. PCI was selected to be the "Prime

Vendor" responsible for purchasing all food items for the troops. This includes contracting with US vendors as well as local Bermuda vendors. The pricing arrangement under the contract provides for PCI to be paid a distribution fee specified in the contract by item and the cost of the items charged by the suppliers/manufacturers. Each quarter the Army reviews the pricing to determine if the suppliers costs are "fair and reasonable". Attached are some excerpts from the contract supplied by the potential relator that sets out the pricing formula and requires that all kickbacks/rebates be reported and refunded. (See Attachment)

Counsel says she is willing to show you some of the documents and play parts of the tapes on a "queen for a day" basis, but refuses to identify her client who is sitting outside in the waiting room of the US Attorney's Office without some assurance he will not be criminally prosecuted. She adds that the two current PCI employees of the contractor remain loyal to the potential relator and says they are willing to be wired. One is a Guatemalan citizen, the other is a retired Master Sergeant. She suggests her client and his former associates not only have evidence of a massive fraud and kickbacks to US suppliers but also believes PCI has lavishly entertained and paid cash bribes to Army supply personnel in Guatemala to persuade them to order higher margin items in the contract.

1. How do you respond to the offer of evidence?
2. How do you deal with the suspicions in the agency?
3. Is this a criminal matter? What offenses? Venue?
4. Wiring the employees overseas?
5. What promises on prosecution of the potential relator can you make?

PHASE 2

One way or another you interview the relator, watch the tapes and learn that the overcharging scheme involves two components: (1) PCI elected to buy all the local items from a Hog On Inc., a company owned and controlled by the largest PCI stockholders family. The relator who is also in the food business provides local price analysis that shows Hog On Inc., (Hog On) is marking up the items such as lettuce, milk, etc., about 300%; and (2) for the US suppliers such as Perdue chicken and Nabisco and other national companies that sell to the government through

distribution arrangements, PCI purchased only from companies that gave it the best payment terms. The key term was a so-called prompt pay discount of 8%. This requires the supplier to raise its prices to accommodate this "term" which is not standard in the business.

1. What do you do next?
2. What is the status of your relationship with the lawyers in the Army overseeing the contract?
3. Do you brief them?

PHASE 3

You now have documents from PCI and all their suppliers. Hog On tells you they would like to cooperate but since they are owned by a Belize Bank, BFH Ltd., they cannot provide any financial records without that government's permission. Because of the prominence of BFH in Belize there is concern in the government that if the investigation expands to Hog On, it could create a financial collapse of their financial markets.

You also find out that the Army was alerted by the PCI in the proposal in a footnote that Hog On was going to be the supplier and that PCI intended to use normal commercial terms with all of its suppliers which involved prompt payment terms that need not be disclosed or returned.

1. Where do you go from here?
2. Is this criminal? Does that influence the approach of the investigation?
3. How and when do you involve the agency? What position do you take on the award of the follow-on contract to PCI?
4. When PCI counsel come in and offer "cooperation", what are you going to expect?
5. How does this story end?

PRICING:

A. Pricing will be based on the following pricing formula:

Unit Price – The unit price is defined as the total price (in U.S. currency) that is charged to DSCP per unit for a product delivered to the Government.

NOTE: Multiple Unit Prices for the same item are not permitted.

Delivered Price – (also known as "product price", and/or "landed costs")

For CONUS purchases – The delivered price is the manufacturer/supplier's actual invoice price (in U.S. currency) to deliver product to the Prime Vendor's CONUS distribution point.

NOTE: For those items being picked up by the Defense Transportation System (DTS) from the manufacturer/suppliers facility (also known as "Source load" or "drop-shipments"), the delivered price is the manufacturer/supplier's actual invoice price (in U.S. currency) for product only. The delivered price in this instance shall not include any transportation costs to the Prime Vendor's CONUS distribution point.

For OCONUS purchases – The delivered price is the manufacturer/supplier's actual invoice price (in U.S. currency) to deliver product to the Prime Vendor's OCONUS distribution point.

NOTE: For those items being delivered directly to the end-user customer from the OCONUS manufacturer/supplier (for example: chemical products) – the delivered price shall not include any transportation costs, as those would be considered as part of the Offeror's Distribution Price.

Distribution Price – The Distribution Price is defined as a firm fixed price, offered as a dollar amount, which represents all elements of the unit price, other than the delivered price. The distribution price typically consists of the Prime Vendor's projected general and administrative expenses, overhead, profit, packaging costs, transportation cost from the Prime Vendor's OCONUS distribution facility(s) to the final delivery point or any other projected expenses associated with the distribution function. This distribution price is intended to reflect the difference between the delivered price and the unit price to deliver the specified product to the ordering activity. This distribution price shall represent the amount to be added to the actual invoice price paid to the manufacturer or supplier by the Prime Vendor for each item. This distribution price shall remain fixed for the base year of the contract, and is subject to any agreed option year adjustments.

Although technically part of the distribution price, for the purposes of this solicitation, ocean transportation costs (the cost of shipping the product from contractor's CONUS facility(s) to the contractor's OCONUS facility(s), aka "Point to Point" delivery), will be deleted from the delivered price. Accordingly, for purposes of submitting offers under this solicitation, ocean transportation costs will be ignored. The Defense Transportation System will handle point-to-Point delivery.

B. The Government's ordering system requires that pricing will be fixed for a certain period of time. Pricing will be at the time of order. These prices will be fixed until delivery, provided that delivery is requested within the time frame of six (6) days starting the day after the order is placed. If delivery is not requested until after this time frame, pricing will be as of the delivery date.

Special Contract Requirements

PRIME VENDOR MANAGEMENT REPORTS:

The fill rate report must be submitted on a weekly basis, every Wednesday no later than close of business. Monthly reports shall be cumulative for a one (1) month period, and must be submitted no later than the seventh (7th) day of the following month; e.g., for the reporting period of January 1 through January 31 – referenced reports must be received by February 7. Note: The Government reserves the right to require the submission of additional reports or the following reports on a more frequent basis.

A. Weekly Fill Rate Report

The Prime Vendor will submit a weekly report reflecting the previous weeks business, by customer per individual distribution platform area and overall, to the DSCP Contracting Officer with the following information:

1. Fill Rate without Substitutions
2. Fill Rate with Substitutions
3. List of all items that were Not In Stock (NIS), returned, damaged, mispicked, etc.
4. List all items that were "substituted", and indicate the reason they were substituted

D. Rebate Reports:

1. Monthly General Rebates – All rebates that have been passed along to the customer via off-price reductions shall be summarized by listing each customer and the rebate amount. Also include the manufacturer offering the rebate and the product usage. The total should be per customer and per contract.

2. Monthly NAPA Report – This report should summarize the savings passed along to the customers in the form of deviated allowances realized as a result of utilizing the NAPA's. The Prime Vendors shall list each customer, the NAPA amount, the manufacturer/broker name, and quantity ordered. NAPA figures should be listed per customer, per contract and per manufacturer.

3. Food Show Rebates – This report should show a detailed break out of all savings received at your Food Show(s). This report is not a monthly requirement, but is based on the time of your Food Show(s). It shall be submitted within 2 weeks after food show savings end showing actual savings. The Prime Vendor shall list each customer, the Food Show amount, the manufacturer/broker name, and quantity ordered. Food Show Rebates should be listed per customer, per contract, and per manufacturer. The total should be per customer and per contract.

E. Monthly Not-In-Stock Report:

Sorted by date order was placed, line item, number of units ordered, number of units not received, total dollar value of units ordered and total dollar amounts of units not received. Dollar amounts will be subtotaled by product category, as well as by overall total.

F. Monthly Rejection Report:

Sorted by line item, number of units received, number of units rejected, total dollar amount of unit received, and the total dollar amounts of units rejected. Dollar amounts should be subtotaled by product category, as well as by overall total.